JAMES R. BROWNING, Clerk

No. 927

In the Supreme Court of the United States

OCTOBER TERM, 1960

JULIAN G. ROGERS, PETITIONER

v.

UNITED STATES OF AMERICA, RESPONDENT

JULIAN G. ROGERS, PETITIONER

v.

UNITED STATES OF AMERICA, RESPONDENT

JULIAN G. ROGERS AND MARGARET H. ROGERS, PETITIONERS

v.

UNITED STATES OF AMERICA, RESPONDENT

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The petitioners pray that a writ of certiorari issue to review the judgments of the United States Court of Appeals for the Sixth Circuit entered in these cases.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 286 F. 2d 277 (1961) (Appendix A, *infra*, pp. 17-31). The judgments of the Federal District Court are not officially reported.

JURISDICTION

The judgments of the Court of Appeals were entered on January 27, 1961 (Appendix A, *infra*, p. 31). The jurisdiction of this Court is invoked under 28 U. S. C. 1254(1).

QUESTION PRESENTED

Taxpayer, a large-scale livestock dealer, upon the advice of a New York financial advisor entered into transactions in farm commodity futures with the sole purpose and intent of protecting himself from the main risks of his business. It was stipulated that the taxpayer did not have a true hedge, but he believed in good faith, and the jury found, that the futures transactions offered a reasonable means of protection against his most serious risk, losses in his accounts receivable with marginal packers resulting from a general decline in livestock prices. The theory of protection of taxpayer's advisor was that declines in livestock prices and resulting loss in accounts receivable would normally be accompanied by a decline in farm commodity prices. Taxpayer sustained losses in his futures transactions. The question is whether they may be treated as ordinary losses in his livestock business under the Internal Revenue Code of 1939, or whether they are losses from futures held by the taxpayer as capital investment and thus subject to the limitations of Section 117 of the Internal Revenue Code of 1939.

STATUTES INVOLVED

The pertinent provisions of Sections 22, 23, 61 and 117 of the Internal Revenue Code of 1939 are set forth in Appendix B, *infra*, pp. 32-33.

STATEMENT

The taxpayer, Julian Rogers, has been a livestock dealer in Kentucky for 50 years. He is the nation's largest independent dealer. During 1947, 1948 and 1949 he bought and sold

1,529,819 head of livestock for which he paid the farmers $85,457,455.44. His operations have made him a one-man support of the farmers' livestock market prices in Kentucky, because he buys more than 50 per cent of all the slaughtered livestock. It was his practice to bid on every animal until all were sold and then to arrange for shipment to packing houses in the Eastern cities. He bought the livestock in his own name and was required to pay for it within 72 hours or at most seven days He operates on a narrow profit margin, and most of his purchases are made at the auction markets. Most of his sales are to marginal meat packers in Eastern cities. (R. 21a, 77a, 141a, 150a, 152a, 153a, 160a, 200a, 244a, Pl. Ex. 16; R. 32a, 34b)

The taxpayer's sales varied from month to month. However, the big and heavy run of livestock started in late August and continued through November. During the heavy runs, he had in transit seven days a week a stream of railcars and trucks, and as many as eighty carloads of livestock at one time. (R. 145a. 148a, 159a)

The taxpayer's principal customers were marginal packers with a small amount of capital and they relied upon him for their financing. In times of economic decline they go broke quickly, and the taxpayer loses the amounts due him. Although the taxpayer has never failed to pay the farmers promptly, he has suffered losses in the hundreds of thousands of dollars and was financially wiped out in 1931 because many of his marginal packer customers went broke. He eventually recovered, but in 1939 his packer customers again suffered financial reverses and almost broke him again. By 1947 he had lost more than two and one-half million dollars from their failures. (R. 143a, 144a, 147a, 148a, 152a, 153a, 161a-164a, 168a)

Early in 1947, his business had slowed up and taxpayer sincerely believed that the country was faced with a severe business decline. At that time his customers owed him about a million dollars. He knew that he had to do something about

his hazardous accounts receivable so he decided to try to protect himself by buying insurance. Thereupon he negotiated with Lloyds and another insurance company. He was willing to pay a reasonable fee for protection, but the premiums asked by the insurance companies were prohibitive and he did not buy. (R. 161a-167a; Pl. Ex. 15; R. 32a, 33b)

Thereupon he consulted the Baxter International Economic Research Bureau, a Wall Street, New York, financial advisory firm. The Baxter firm had among its clients such companies as Montgomery-Ward, Sears-Roebuck, Procter and Gamble, and Armour and Company. The taxpayer knew the firm was expert in financial and business matters, and he requested advice on how to protect himself from his risks and hazards. The taxpayer's request for advice was by telephone late in 1946 or early 1947 and his conversation was with Mr. Irving Weiss, a member of the Baxter organization. (R. 68a, 69a, 71a, 76a, 167a, 168a)

At that time the taxpayer had a lengthy discussion with Mr. Weiss about his livestock business and he told Mr. Weiss of the worries over his hazardous situation. He gave Mr. Weiss the facts of his business and of his main risk of accounts receivable with marginal packers and of all the other risks and hazards of his livestock business. He conveyed to Mr. Weiss his deep fear that the country might be heading into a depression resulting in bankruptcy for many marginal packers. Mr. Weiss agreed. (R. 76a-78a, 120a, 121a, 168a, 169a)

The taxpayer told Mr. Weiss how fast the marginal packers could go bankrupt because of lack of capital and heavy overhead. He gave Mr. Weiss the amount of accounts receivables which could accumulate in a short time. The taxpayer told Mr. Weiss he would go broke again if he did not get insurance or protection of some kind. He also told Mr. Weiss that he was in the 70 to 90 per cent Federal income tax bracket. (R. 77a, 78a, 168a, 170a)

The taxpayer asked Mr. Weiss if he could find some way or could suggest some method to protect him. Mr. Weiss

suggested insurance from a company and taxpayer told him the premiums were prohibitive, costing 65 to 70 cents on the dollar ($650,000 on a million). (R. 78a, 166a-169a)

A few days later Mr. Weiss telephoned the taxpayer. He said that the organization after considering the problem had decided that, since insurance was prohibitive, the only remaining reasonable means of insurance was to enter the commodity futures market on a substantial scale. Because he was advised that this was the only reasonable means of insurance and protection from the hazards in his livestock business, the taxpayer went into the commodity futures market in a substantial way in 1947 and remained in it during 1948 and 1949. The taxpayer's sole purpose was to get insurance and protection. (R. 47a, 77a-81a, 122a, 160a-171a)

During the three years involved, Mr. Weiss conferred with the taxpayer several times a week and sometimes twice a day. The taxpayer and Mr. Weiss discussed his livestock inventory situation, the markets in cattle and packers, the amounts of the accounts receivable and the financial condition of the marginal packers and other factors of his business. The taxpayer kept Mr. Weiss fully informed as to the picture of the livestock market on a day-to-day basis. (R. 78a, 99a, 100a, 101a, 169a, 170a)

With the facts in hand, Mr. Weiss then worked out a consistent pattern of dealing in commodity futures to fix taxpayer's risks and designed to give him protection. Mr. Weiss' basic theory was that there was a close relationship between the livestock and commodity futures markets, both being sections of the agricultural economy and commodities being the foodstuff for the livestock. Mr. Weiss testified that he had made a correlation study of the commodity futures market and the livestock market before the taxpayer consulted him. He believed taxpayer could take positions in commodity futures which would offset in whole or in part any losses taxpayer might suffer in his business. (R. 126a)

Mr. Weiss and taxpayer, working together, followed

livestock prices very closely and made commitments in conjunction with livestock prices, and if livestock prices rose, they took a position in accordance, and if livestock prices declined, they took a position accordingly; that they related the amount of commitments in commodity futures to the day-to-day or week-to-week livestock inventory (treating both livestock and accounts receivable as inventory); and that they consistently made commitments in those commodities associated with the farm, with livestock, and with farm products which generally went into feedstuffs, rather than metals and sugar, which they considered as having nothing to do with taxpayer's business. (R. 79a-80a)

The operation of the plan had the following result. In the beginning of the year the taxpayer would sell short for delivery later in the year. If the prices of the futures went up, he had losses. If the prices of the futures went down, he had profits. In the event of an economic decline the taxpayer would have losses in his accounts receivable, but he would have offsetting profits in his commodity futures. If the economy improved instead of declining, the taxpayer would have losses in his commodity futures, but the marginal packers would be able to liquidate the taxpayer's accounts receivable. Losses in the commodity futures was the insurance premium for the protection of the accounts receivable. (R. 25a, 77a, 79a, 81a, 82a, 120a, 123a, 124a, 130a-132a, 134a, 252a.)

Upon the basis of a commitment plan geared to the taxpayer's risks, Mr. Weiss advised the taxpayer exactly what purchases or sales should be made. The taxpayer always followed his advice. The livestock and commodity transactions were entered in the same books and records, and the commodity transactions were treated as a part of the livestock business. (R. 26a, 28a, 78a-80a, 170a, 175a, 177a)

The uncontradicted testimony of both Mr. Weiss and Mr. Rogers is that taxpayer went into the commodity futures market for the sole purpose of protection against his business risks. (R. 166a, 170a-171a)

Taxpayer suffered losses in his futures transactions in the following amounts: 1947, $98,227.52; 1948, $267,491.74; 1949, $77,211.41. (R. 8a)

The cases were submitted to the jury on instructions stated in three identical interrogatories. Each interrogatory was in three parts. The first part referred to the risks and hazards of the taxpayer's business. The second and third stated that losses in futures transactions were ordinary deduction if the jury found (2) that taxpayer "engaged in purchasing and selling Commodity Futures with the sole and only purpose and intention of affording himself protection from losses in his business, and (3) further find from the evidence that the dealings by the Plaintiff in Commodity Futures afforded a reasonable means for protection from such losses, in whole or in part, and in that respect and for that reason had such direct relation to the hazards of his business of purchasing and selling livestock as constituted his dealings in Commodity Futures an integral part of his livestock business." (R. 300a-301a). These instructions were not objected to. The jury returned a verdict for the taxpayer in all three cases.

The Court of Appeals conceded that there was substantial evidence that taxpayer engaged in futures transactions with the sole and only purpose of protection. Therefore the questions raised by this petition relate only to the third part of the District Court's instructions.

REASONS FOR GRANTING THE WRIT

I. The Court of Appeals Has So Far Departed from the Accepted Standards of Reviewing the District Court's Instructions to the Jury as to Call for an Exercise of this Court's Power of Supervision.

It is standard procedure that instructions not objected to are the law of the case on appeal, and the sufficiency of the evidence necessary to sustain the verdict must be tested by the law announced in such instructions. *National Surety Corp.* v. *Excelsior Springs* (8th Cir., 1941), 123 F. 2d 573; *Trans-*

American Freight Lines, Inc. v. *Universal Die Casting Co.* (6th Cir., 1951), 192 F. 2d 931. The instructions in the instant case are quoted above in the Statement. The Court of Appeals did not apply as the law of the case the instruction that if the transactions in commodity futures offered taxpayer *"a reasonable means of protection"* when the protection was secured then they would be a part of his business. The Sixth Circuit required more than a reasonable means. They required that the protection as a fact be guaranteed successful at the time it was secured, or, in other words, a true hedge. The law adopted by the Sixth Circuit was (Appendix A, *infra*, p. 24)

> "• • • there must be a direct relation between the product that is the basis of the taxpayer's business and the commodity futures in which he deals for protection. There must also be a relation between the prices of the product and the commodity. In order to really secure protection with some degree of certainty and without indulging in pure speculation the prices of the commodity futures must move up and down closely with the prices of the product of the business."

The line of difference is that (1) the District Judge required that when the protection was secured there must be *reasonable ground for believing* that a degree of certainty of success of protection existed. (2) The Sixth Circuit required that there must be *in fact* "a degree of certainty" of the success of the protection at the time insurance was secured.

By restating and changing the law by which the sufficiency of the evidence was to be tested, the Court of Appeals made the question on appeal a legal one. The question became, what is the correct legal standard to apply to the evidence to determine if taxpayer's losses were ordinary losses? It was error to treat on appeal a legal question of the correctness of instructions. The sole question should have been the sufficiency of the evidence under the instructions given by the

District Court. As stated by Judge Miller in his dissenting opinion (Appendix A, *infra*, pp. 26, 27)

". . . But the transactions in commodity futures in the *Corn Products Refining Co.* case were not "true hedges," and yet the resulting gains and losses were held to constitute ordinary income and ordinary deductions, for the reason that they were vitally important to the company's business as "a form of insurance" against increases in the price of raw corn. Accordingly, the issue in the present case is not whether the taxpayer's dealings in commodity futures constituted a "true hedge" but whether they constituted an integral part of his livestock business. *Corn Products Refining Co.* v. *Commissioner*, supra, 350 U.S. 46, 50-51, 76 S. Ct. 20, 100 L. Ed. 29;

* * * * *

"As stated in the Corn Products Refining Co. case, this is essentially a factual question. The District Judge submitted this factual question to the jury by means of an interrogatory. . . . I am of the opinion, and the parties seem to agree, that this interrogatory correctly presented the issue. It was not objected to by Government counsel. On this factual question the jury found for the taxpayer."

"Accordingly, there is no legal issue involved in this appeal. It was purely a question of fact for determination by the jury under proper instructions from the Court. Unless the evidence was insufficient to take this factual issue to the jury, the judgment should be affirmed. *Corn Products Refining Co.* v. *Commissioner*, supra."

It was error not to have followed the law as laid down by the District Judge in his instructions.

II. The Decision of the Court of Appeals is in Conflict with Corn Products Co. v. Commissioner, 350 U.S. 46 (1955).

This Court in *Corn Products Co.* v. *Commissioner*, 350 U.S. 46 (1955), held that gains and losses in commodity futures constitute ordinary income and ordinary deductions when they are a form of partial insurance against hazards of the taxpayer's business, and thus an integral part of his business. As stated in *Corn Products*, supra, this is essentially a factual question. The Court of Appeals did not so treat it.

The Court of Appeals held, first, that in order for futures transactions to be an integral part of the business that there must be "a direct relation" between the futures and the product that taxpayer manufactures or deals in, and that the prices of the futures and the prices of taxpayer's product "must move up and down closely." Secondly, it held that there must *in fact* be "some degree of certainty" that taxpayer was getting protection.

The first holding of the Court of Appeals proceeds upon the theory that a true hedge is required. Judge Miller in his dissent stressed this by saying that "the issue in the present case is not whether taxpayer's dealings in commodity futures constituted a 'true hedge.'" (Appendix A, *infra*, p. 27) The Court of Appeals requires the prices of the futures and the *prices* of the *product* to move up and down closely, and it rejects the theory that a businessman can protect against a loss in one market (livestock, here) by taking a correlative position in another market (farm commodity futures) to which the former market may reasonably be assumed to be related. This is contrary to the *Corn Products* case. In *Corn Products* there was not a true hedge, and there was no necessary economic relation between the prices of corn and prices of the taxpayer' product. The price of corn was only one of many factors which would affect the price of the manufactured product. In fact the many factors which affect the price of corn are not identical with the factors which affect the syrup

product from corn. For instance, the price of corn may soar, but the competition of syrup made from cane and beet may keep the price of corn syrup down as pointed out in the *Corn Products* case. Actually, in that case the futures were used to help protect the profit against the prices of competing syrup made from cane and beets.

The second standard applied by the Court was that there must be at the time the hedging takes place "some degree of certainty of protection" *in fact*.[1] If this is not merely a restatement of the requirement of a true hedge, it must mean that there must be an absolute guarantee (in advance) that the insurance or protection will be successful (before the cost of the insurance may be deducted). The proper basis of the deductibility of insurance premiums is not, however, that the taxpayer is certain of protection but that he *reasonably believes* that he is getting protection. If the standard applied by the Court is correct, then "the fortuitous ineffectiveness of an insurance policy (would) prevent premiums paid from being treated as expended for insurance purposes." *Albert Kurtin*, 26 T.C. 958 (1956). This cannot be the law. If it is, then the test of what constitutes "ordinary and necessary" business expense becomes not the reasonable man in the business context, but the certainty of result. Applying the "certainty of result" test to other types of business expenses, such as advertising, would cause untold confusion and uncertainty in the administration of the tax laws.

The policy basis, underlying the "ordinary and necessary" test for deduction of business expenses, is that we must rely on the judgment of businessmen as to what expenditures are necessary to make their businesses profitable. So long as their judgment is within the bounds of reason, it must be respected by the taxing authorities. This policy, and not a policy of

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[1] The Sixth Circuit admitted that protection did result to taxpayer, but it stated that the protection was "purely accidental" and not certain at the time it was secured. (Appendix A, *infra*, p. 25)

guaranteed success or of taxing authorities' second-guessing business judgment, underlies the *Corn Products* case. It was not applied by the Court of Appeals in the case at bar.

Furthermore, it is clear that to follow the "degree of certainty" theory would be a narrow rather than a broad interpretation of the ordinary income and loss provisions of the Internal Revenue Code. (*Corn Products Co.*, supra)

III. There is a Conflict Between the Court of Appeals and the Tax Court.

The decision of the Court of Appeals is in conflict with *Albert Kurtin*, 26 T. C. 958 (1956), acquiesced in 1957 I CB4. In *Kurtin* taxpayer was in the business of wholesaling cheese and eggs. To protect against a decline in cheese prices, taxpayer sold butter futures short. There was no futures market in cheese. Due to unusual circumstances the butter market was sustained while the cheese market declined. The result was that taxpayer sustained losses, and the insurance he sought did not materialize. The Tax Court held the losses were allowable in full as hedging transactions under the *Corn Products* case. The Court said (26 T.C. at 960-961):

> "The uncontradicted testimony was that there is no futures market for cheese but that the price of cheese, being dependent on butterfat, normally fluctuates with that of butter as to which the sale of futures is available. Under ordinary circumstances petitioner could hence look forward to recovering on closing out the futures transactions at least a part of the loss occasioned by any decline in cheese prices between the date of commitment and the time of delivery. This was as appropriate a hedge as was available to petitioner."
>
> * * * * *
>
> "* * * The result to petitioner was that the insurance he sought did not materialize. But we think that circumstance along with the other facts no more deprives this arrangement of its qualities as an attempted hedging

operation than would the fortuitous ineffectiveness of as insurance policy prevent premiums paid from being treated as expended for insurance purposes."

The Tax Court held that when there is not a futures market in taxpayer's product he may seek protection in a futures market related to his product. Moreover, it held that the fact that the sought after insurance did not materialize because the markets did not move down together was irrelevant. The means used by *Kurtin* to get protection were almost precisely the same means used by taxpayer in the instant case. There was no futures market in livestock, so he went into a related market—farm commodity futures—seeking protection. He believed that the two markets were closely related and that he could protect against livestock price declines by selling short farm commodity futures. This was, as in *Kurtin*, as appropriate a hedge as was possible under the circumstances. Moreover, taxpayer here actually did get protection, something the taxpayer in *Kurtin* did not get.

In holding that one must seek hedging protection in the futures market of his business product, and if there is no futures market, he cannot hedge, the Court of Appeals is in conflict with the Tax Court. In holding that there must be a certainty of protection, the Court of Appeals is also in conflict with the Tax Court. These conflicts raise two important issues under the federal tax laws that should be resolved by this Court.

IV. The Court of Appeals Has So Far Departed from the Accepted and Usual Course of Appellate Review of a Jury's Findings of Fact as to Call for Exercise of this Court's Power of Supervision.

The decision of the Circuit Court that there was no evidence from which a jury could find that taxpayer's commodity futures transactions were an integral part of his live-

stock business was a clear departure from the usual standards of judicial review. The proper standard of review requires an appellate court to sustain a jury verdict "when there is some evidence which the jury might have believed, and when a reasonable inference from that evidence will support the verdict." *Orvis* v. *Higgins* (2d Cir., 1950), 180 F. 2d 537, 538, cert. den. 340 U.S. 810 (1950). This has been held many times by this Court. *Commissioner* v. *Duberstein*, 363 U.S. 278, 291 (1960); *Lavender* v. *Kern*, 327 U.S. 645, 653 (1946); *Gunning* v. *Cooley*, 281 U.S. 90 (1929); *Delaware, L. & W. Ry. Co.* v. *Converse*, 139 U.S. 469 (1891). When the instructions to the jury are not objected to (and they were not objected to in this case), they become the law of the case and the sufficiency of the evidence must be tested by those instructions.

The jury heard the taxpayer and the taxpayer's advisor and expert, and then it heard the economic experts of the Government. (Testimony for the taxpayer is summarized in the statement of facts.) Thereupon the jury decided for the taxpayer. Either (1) the jury did not follow or believe the Government experts—and they had that right, or, (2) they believed the taxpayer and his advisor, Mr. Weiss—and they had that right. The jury had a right to believe the taxpayer, when he testified that he believed that the means he had were reasonable and that he made the futures a part of his business. They had a right to believe Mr. Weiss when he testified that the taxpayer used a reasonable means of insurance and protection and that the futures were an integral part of taxpayer's livestock business. The credibility of the witnesses was solely within the province of the jury. The jury was instructed by the District Judge, without objection, that they were the sole and only judge of the credibility of the witnesses.

Further, the facts clearly revealed that the taxpayer had a form of insurance as required by this Court as Judge Miller pointed out in his dissenting opinion (Appendix A, *infra*, pp. 29-30)

"... the operation of the plan had the following practi-

cal result. In the early part of the year the taxpayer would sell short for delivery later in the year. If the price of the futures went down, he made profits. If the price of the futures went up, he had losses. In the event of an economic decline the taxpayer would have losses in his accounts receivable, but would have offsetting profits in his commodity futures. If business improved instead of declining, the taxpayer would have a loss in his commodity future, but the marginal packers would be able to liquidate taxpayer's accounts receivable. Losses in the futures was the insurance premium for the protection of the accounts receivable."

Still further the majority of the Sixth Circuit acknowledged that the taxpayer had *in fact* secured the protection he desired, where they said (Appendix A, *infra*, p. 25):

"• • • The fact that he lost in one and gained in the other was not due to any balancing relationship between the two business ventures."

They said the fault they had with it was that it was not predictable at the time he secured it and therefore his success in having the protection was accidental—not a certainty when secured. As heretofore stated, this is an improper standard to apply to business deductions.

The Sixth Circuit seemed to imply some fault with the desirability of making profits to be balanced with losses. In the *Corn Products* case, supra, the Supreme Court held that futures transactions entered into for a profit will be a part of taxpayer's business if and when the profits from the futures are used to protect the profits or balance out the losses in the main business—where there is *intent* for protection and insurance and there is a form of insurance. It is clear that, in any such form of insurance, you secure protection when you acquire the balance between profits on one side and losses on the other.

We have, therefore, a situation in which the taxpayer sought protection, he used reasonable means, he personally intended to make and did make the futures a part of his business, he had a form of insurance and he *in fact* had insurance and protection.

There was, therefore, more than sufficient evidence to sustain the verdict of the jury. The Court of Appeals, in weighing the evidence, invaded the province of the jury. In so doing it ignored the teaching of *Commissioner* v. *Duberstein*, supra, wherein the Supreme Court reversed the Sixth Circuit for overturning findings of the Tax Court in an analogous situation.

CONCLUSION

For the reasons stated this petition for a writ of certiorari should be granted.

Respectfully submitted.

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Dated: April, 1961

APPENDIX A

1. *Opinion of the Court of Appeals*

No. 14086

United States Court of Appeals for the Sixth Circuit

UNITED STATES OF AMERICA, *Appellant*
v.
JULIAN G. ROGERS, *Appellee.*

UNITED STATES OF AMERICA, *Appellant*
v.
JULIAN G. ROGERS, *Appellee.*

UNITED STATES OF AMERICA, *Appellant*
v.
JULIAN G. ROGERS and MARGARET H. ROGERS, *Appellees.*

ON APPEAL from the United States District Court, for the Eastern District of Kentucky

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Decided January 27, 1961

Before: MILLER, CECIL and WEICK, Circuit Judges.

CECIL, Circuit Judge. This is an appeal from judgments of the United States District Court for the Eastern District of Kentucky. Julian G. Rogers, filed three separate actions in the District Court for the refund of income taxes for the years 1947, 1948 and 1949. In 1949 he filed a joint return

with his wife Margaret H. Rogers and she is a co-plaintiff with him for the recovery of taxes for that year. The three cases were consolidated for trial and were tried to a jury resulting in verdicts for the taxpayers in all three cases. Judgments in the sum of $418,566.46 were entered upon the verdicts and the government appealed.

Julian Rogers sometimes hereafter referred to as the taxpayer was in the livestock business for the tax years in question and had been in such business for many years prior thereto. He bought cattle, hogs and lambs from farmers and at the auction markets in Kentucky. He immediately sold the livestock so purchased, mostly to independent or marginal meat packers in Eastern cities. He made some sales to commission merchants in terminal markets. He did business on a very large scale and was one of the largest single purchasers of livestock in the auction markets. His gross sales for the years 1947, 1948 and 1949 were in excess of $29,000,000, $32,000,000 and $23,000,000, respectively. During the tax years involved here, he purchased as much as 50 per cent of the fat cattle sold at auction. He bought the livestock in his own name and was required to pay for it in 72 hours or at most in seven days. Shipment was made by rail and truck and it took from two and a half to five days for a load to reach its destination. His best customers paid within a week to ten days but many delayed payment as long as six months. Some never paid. Late in 1946 or early 1947 Rogers had about $1,000,000 outstanding in accounts receivable from his marginal-packer customers. At this time he believed that there was danger of a depression or a severe decline in business.

Rogers was confronted with four risks of loss in his livestock business which may be stated briefly as follows: Price declines in transit, shrinkage and damage in transit, terminal market losses and accounts receivable losses. The first three were natural and ordinary hazards of the business. The danger of loss of accounts receivable increased with any decline in general business conditions. He estimated his

losses through price declines for the years 1947, 1948 and 1949 at approximately $163,000. The total losses in accounts receivable for the same years were $964,000. More than two-thirds of this was lost through one company, The American Packing Company, of Hoboken, New Jersey.

Mr. Rogers had suffered severe business reverses on at least two prior occasions and he was desirous of protecting himself against another such reverse. He discussed his situation with Mr. Weiss, of the Baxter International Economics Research Bureau. He described the nature of his business and the risks with which he was confronted and told him that he was in a seventy to ninety per cent tax bracket. Mr. Weiss advised Rogers to enter the commodities futures market on a large scale as "the only means of insurance" against losses in his livestock business.

Acting upon this advice Mr. Rogers sold a large amount of his $300,000 of investments in stocks and securities and entered the commodities futures market in a substantial way. He had dealt in a modest way in commodity futures during the years 1945 and 1946. Gains from these transactions were treated for income tax purposes as capital gains. In the beginning of 1947 Mr. Rogers instructed his accountant to treat gains and losses from commodity futures transactions as gains and losses in ordinary income.

Mr. Rogers dealt with two brokerage firms in Lexington, Kentucky, and traded in futures in wheat, oats, corn, lard, soybeans, cotton and eggs. He bought and sold on the advice of Mr. Weiss. They held frequent telephone conversations. Sometimes these were daily. He bought and sold in varying quantities, from day to day, taking short and long positions. Futures were closed out daily, weekly and monthly. For the three years in question there were over eighteen hundred opening contracts in futures commodities. The total value of such transactions in 1947 exceeded eight million dollars. There was a similar pattern of trading in the other two years. The taxpayer's profits or losses on these trans-

actions resulted from fluctuations in the prices of futures. The transactions for the years here under consideration resulted in losses and for tax purposes the taxpayer treated them as losses of ordinary income.

The Commissioner of Internal Revenue determined that the losses were from capital investments and on April 26, 1956 issued notices to the taxpayers of the deficiencies which are the subject of these actions.

The parties entered into stipulations as follows:

> "1. There is no dispute as to the amount of tax and interest in controversy in any of the foregoing three cases (and that refers to the 1947 case, the 1948 case and the 1949 case) and further that the amount of the refund, if any, due the plaintiff or plaintiffs can be determined by the parties after the jury has returned its verdict.
> "2. That the plaintiff Julian G. Rogers' transactions in the commodities futures market during the pertinent period did not constitute 'true' or technical hedges as the term 'hedge' is defined in General Counsel's Memorandum 17322, CB XV-2, page 151 et seq.".

The appellant contends that the trial judge erred as a matter of law in submitting the case to the jury.

The law of the cases as adopted by the trial judge is stated in an interrogatory which he submitted to the jury in each of the cases. The interrogatories were identical and we will refer to only one of them. It consisted of three parts. The first referred to the nature of the taxpayer's business and the hazards of loss to which he was subjected. The second provided that he must have entered the commodities futures market in good faith for the sole purpose of protecting himself from the hazards of loss in the business. The third contains the essence of the law and reads as follows: ". . . and further find from the evidence that the dealings by the Plaintiff in Commodity Futures afforded a reasonable means for

protection from such losses, in whole or in part, and in that respect and for that reason had such direct relation to the hazards of his business of purchasing and selling livestock as consituted his dealings in Commodity Futures an integral part of his livestock business?"

This statement of the law contains two essential elements, one, there must be a direct relation to the hazards of the business of buying and selling livestock and, two, the dealings in commodity futures must constitute an integral part of the livestock business.

One of the cases relied on by the trial judge and cited by counsel on both sides is known as the *Corn Products* case, *Corn Products Refining Co.* v. *Commissioner,* 350 U.S. 46, 76 S. Ct. 20, 100 L. Ed 29. This is the leading case on the subject. Corn Products Company, the taxpayer, is a manufacturer of products made from grain corn. In 1937 it began buying corn futures "'as a part of its corn buying program' and 'as the most economical method of obtaining an adequate supply of raw corn, without entailing the expenditure of large sums for additional storage facilities." Its method of operation as described at page 48 of 350 U. S., at page 22 of 76 S. Ct. was as follows: "At harvest time each year it would buy futures when the price appeared favorable. It would take delivery on such contracts as it found necessary to its manufacturing operations and sell the remainder in early summer if no shortage was imminent. If shortages appeared, however, it sold futures only as it bought spot corn for grinding. In this manner it reached a balanced position with reference to any increase in spot corn prices. It made no effort to protect itself against a decline in prices." The company made a profit in excess of $600,000 in corn futures in 1940 and in 1942 it lost slightly over $100,000. The taxpayer reported these gains and losses as ordinary profit and loss from manufacturing operations. It later sought to amend its returns and treat them as arising from the sale of capital assets. In support of this position, it claimed that its trading in futures

was separate and apart from its manufacturing operations.

As stated at page 50 of 350 U. S., at page 23 of 76 S. Ct., "Both the Tax Court and the Court of Appeals found petitioner's futures transactions to be an integral part of its business designed to protect its manufacturing operations against a price increase in its principal raw material and to assure a ready supply for future manufacturing requirements."

It was held by the Supreme Court that these findings presented questions of fact. On this authority the trial judge in the case at bar considered that, if the taxpayer entered the futures market in good faith, to protect himself from losses in his business, a question of fact was presented for the jury to determine, whether it was an integral part of his business. In this respect it must be borne in mind that the Corn Products Company was trading in futures in corn which was the very basis of its manufacturing business.

In affirming the Tax Court and the Court of Appeals in their findings that the Corn Products Company's dealings in futures was an integral part of its business, the Court very clearly outlined a basic rule, 350 U. S. at page 50, 76 S. Ct. at page 23: "We find nothing in this record to support the contention and Corn Products' futures activity was separate and apart from its manufacturing operation. On the contrary, it appears that the transactions were vitally important to the company's business as a form of insurance against increases in the price of raw corn. Not only were the purchases initiated for just this reason, but the petitioner's sales policy, selling in the future at a fixed price or less, continued to leave it exceedingly vulnerable to rises in the price of corn. Further, the purchase of corn futures assured the company a source of supply which was admittedly cheaper than constructing additional storage facilities for raw corn. Under these facts it is difficult to imagine a program more closely geared to a company's manufacturing enterprise or more important to its successful operation."

The District Judge also relied on *United States* v. *Bondurant*, 6 Cir., 245 F. 2d 265, as authority for submitting the case to the jury. (267a Appellant's Appendix.) The Judge recognized that it was not analogous and aside from the fact that the issue presented a question of fact for a jury, it has no bearing on the case at bar. Here the taxpayer was a cotton shipper whose principal business was buying and selling cotton. In addition to his regular cotton shipping business he wanted to invest in cotton in such a way as to make any profit resulting therefrom a capital gain. His tax counsellor advised him that this could be done if he kept it separate in every way from his regular business. The similarity between his cotton shipping business and his investment cotton venture gave rise to the claim, on the part of the government, that profits from the investment venture were ordinary income. Whether he had sufficiently segregated the investment business so as to distinguish it from his regular business was held to be a jury question.

In *Trenton Cotton Oil Co.* v. *Commissioner of Internal Revenue*, 6 Cir., 147 F. 2d 33, at page 35, the court said "Losses from counter contracts made by manufacturers to protect themselves against fluctuations of markets in the purchase of raw material in advance of use, or sales of manufactured goods in advance of production, are treated under the Internal Revenue Statutes as ordinary business expenses, and gains from such sources are treated as ordinary income. *Ben Grote* v. *Com'r*, 41 B. T. A. 247; G. C. M. 173.22, XV-2, Cum. Bull. 151 (1936). Purchases and sales against price fluctuations are insurance against loss and such transactions have a direct relationship to profit realized or loss sustained in the conduct of a business.

"Before such a loss may become allowable as a business expense, it must be made to appear that a contract has been entered into for the sale and delivery of a product at a future date and that there is a counter contract for the purchase of the same product for future delivery or one so akin to it that

it affects the price of the former. The whole theory is that when the price goes up or down the gain on one transaction will offset the loss on the other. The price relationship, as shown by the evidence, between crude and refined oil is so intimate that the purchase of the latter for future delivery may be used as an insurance against risk of loss on the former sold for future delivery and the same is true as to the price relationship between refined oil and cottonseed."

See also *Commissioner of Internal Revenue* v. *Farmers & Ginners Cotton Oil Co.*, 5 Cir., 120 F. 2d 772, at page 774, where the court said: "A hedge is a form of price insurance; it is resorted to by businessmen to avoid the risk of changes in the market price of a commodity. The basic principle of hedging is the maintenance of an even or balanced market position. To exercise a choice of risks, to sell one commodity and buy another, is not a hedge; it is merely continuing the risk in a different form. That is what the taxpayer did in this case. It did not retain its crude oil and sell refined; it sold crude and bought refined when it had no actual commodity on hand or future commitments to be protected from price variations."

[1] A thread that runs through all of the cases is that there must be a direct relation between the product that is the basis of the taxpayer's business and the commodity futures in which he deals for protection. There must also be a relation between the prices of the product and the commodity. In order to really secure protection with some degree of certainty and without indulging in pure speculation the prices of the commodity futures must move up and down closely with the prices of the product of the business.

The parties stipulated that Mr. Rogers' transactions in commodity futures were not a "true hedge" against losses in his livestock business. The implication is that these dealings constituted some kind of a hedge. However, no theory is advanced as to how his method of operation would produce a hedge or any protection against the hazards of loss to which he was subjected in the business of buying and selling live-

stock. Neither are there any authorities cited to substantiate the position of the taxpayer.

The evidence does not disclose any relationship between Mr. Rogers' livestock business and the commodity futures in which he dealt. Neither does it show any relationship between the prices of those commodities and livestock. Furthermore, the evidence shows that he bought and sold commodity futures without any regard for his purchases and sales of livestock.

There was nothing scientific about his methods. There was no pattern of operation whereby losses through transactions in the commodity futures market might be considered as losses of ordinary income as recognized by the cases above cited.

[2] Considering the evidence in the most favorable light to the plaintiff it would support a finding of the jury that Mr. Rogers honestly and in good faith entered the commodity futures market for the purpose of making a profit to offset his anticipated losses in his livestock business. Or, to put it another way, to protect himself from the hazards of the business. Good faith is not enough. The business of dealing in commodity futures must constitute an integral part of his livestock business. It cannot become such a part of his business just because he has an honest intention to make it so.

The evidence shows that any gains through declines in commodity futures to offset losses through the hazards of the livestock business would be purely accidental. In dealing in commodity futures the plaintiff took on an additional risk Instead of gaining in the commodity market he lost. Fortunately for him he did not lose through the hazards of his livestock business. The fact that he lost in the one and gained in the other was not due to any balancing relationship between the two business ventures.

It is said that losses from dealings on commodity exchanges fall into three general classes: "• • • hedges, wagering con-

tracts, and legitimate capital investments. Losses from true hedges are allowed in full. * * * Capital losses are allowed only to the extent of $2,000 plus the gains from sales or exchanges." *Commissioner of Internal Revenue* v. *Farmers & Ginners Cotton Oil Co.*, supra; *United States* v. *New York Coffee and Sugar Exchange*, 263 U. S. 611, 44 S. Ct. 225, 68 L. Ed. 475.

We conclude that plaintiff's dealings in commodities were purely speculative and fell in the class of legitimate capital investments. There is no evidence upon which a jury could base a finding that these investments were an integral part of the plaintiff's livestock business. The government's motion for a directed verdict should have been granted.

The judgments are reversed and the cases remanded to the District Court with instructions to dismiss the complaints.

SHACKELFORD MILLER, JR., Circuit Judge, (dissenting).

I am of the opinion that the judgments in these cases should be affirmed on the authority of *Corn Products Refining Co.* v. *Commissioner*, 350 U. S. 46, 76 S. Ct. 20, 100 L. Ed. 29.

As pointed out in the opinion in that case it is settled law that hedging transactions are essentially to be regarded as insurance rather than a dealing in capital assets and that gains and losses therefrom are ordinary business gains and losses. I recognize that in the present case it was stipulated by the parties that the taxpayer's transactions in the commodity futures market during the taxable years in question did not constitute "true" or technical hedges as the term "hedge" is defined in General Counsel's Memorandum 17322. But the transactions in commodity futures in the *Corn Products Refining Co.* case were not "true hedges," and yet the resulting gains and losses were held to constitute ordinary income and ordinary deductions, for the reason that they were vitally important to the company's business as "a form of insurance" against increases in the price of raw corn. Accordingly, the

issue in the present case is not whether taxpayer's dealings in commodity futures constituted a "true hedge" but whether they constituted an integral part of his livestock business. *Corn Products Refining Co.* v. *Commissioner*, supra, 350 U. S. 46, 50-51, 76 S. Ct. 20, 100 L. Ed. 29; *Mansfield Journal Co.* v. *Commissioner*, 6 Cir., 274 F. 2d 284, 286.

As stated in the *Corn Products Refining Co.* case, this is essentially a factual question. The District Judge submitted this factual question to the jury by means of an interrogatory. Under this interrogatory, in order for the taxpayer to recover, the jury was required to find from the evidence that the taxpayer, in good faith, "engaged in purchasing and selling Commodity Futures with the sole and only purpose and intention of affording himself protection" from his business losses and that it "afforded a reasonable means for protection from such losses, in whole or in part, and in that respect and for that reason had such direct relation to the hazards of his business of purchasing and selling livestock as constituted his dealings in Commodity Futures an integral part of his livestock business." I am of the opinion, and the parties seem to agree, that this interrogatory correctly presented the issue. It was not objected to by Government counsel. On this factual question the jury found for the taxpayer.

Accordingly, there is no legal issue involved in this appeal. It was purely a question of fact for determination by the jury under proper instructions from the Court. Unless the evidence was insufficient to take this factual issue to the jury, the judgment should be affirmed. *Corn Products Refining Co.* v. *Commissioner*, supra.

The Government put in evidence the testimony of three expert witnesses who testified to the nonrelationship between the risks of loss in taxpayer's livestock business and his trading in commodity futures. In their opinion, the taxpayer could not protect himself against losses in his livestock business by his tradings in commodity futures. These witnesses, however,

were not men with practical experience in the livestock business.

The taxpayer, in his behalf, introduced the testimony of a Mr. Weiss, who was the senior partner of a "Wall Street" firm of investors and business and financial advisors. Mr. Weiss began his business career in Wall Street in 1928, became a partner in a produce exchange, and later became affiliated with several firms, including the International Economic Research Bureau, which later became the Baxter International Economic Research Bureau, of which Mr. Baxter was the head. He was with the Baxter firm from about 1937 to 1955, becoming second to Mr. Baxter before leaving that firm. The Baxter firm did considerable work with such firms as Montgomery-Ward, Sears-Roebuck, Proctor and Gamble, W. T. Grant Co., and Continental Can Co., and also had clients engaged in the packing industry.

Appellee was a client of the Baxter firm and had been in contact with it once or twice during 1945 or 1946. Mr. Weiss testified that during the early part of January 1947 appellee had a lengthy conversation with him over the phone about his business and its hazards. The taxpayer had at the time about $1,000,000.00 of outstanding accounts receivable and was of the opinion that there was danger of a business depression or a severe decline in business in 1947. He was dealing with second, third and fourth-rate packers, who in the event of a business depression probably couldn't pay. The taxpayer had gone broke twice before and asked Mr. Weiss if his organization could suggest some method to help him. Mr. Weiss stated that he would like to discuss it with others in his organization. After some ten days or two weeks he called the taxpayer and told him that his organization had two alternative suggestions, the first being to insure the accounts receivable, and the second being to enter the commodity futures market on a substantial scale. The taxpayer stated that he had already tried to insure the accounts receivable, but that the cost was prohibitive. Accordingly, the second suggestion was adopted and followed.

Mr. Weiss testified that in his opinion as a financial and business advisor, going into the commodity futures market would provide the taxpayer protection against the risks in the livestock business; that in view of the high federal income tax bracket applicable to the taxpayer he would not have advised him to go into the commodity futures market under ordinary circumstances, but the advice was given because of the many hazards of his livestock business, and that it was their view, upon which the decision was made, that the taxpayers entrance into the commodity futures market was a reasonable means for the protection of the taxpayer against the risks and hazards of his livestock business. Mr. Weiss also testified that he and the taxpayer worked together in the matter, the taxpayer continually giving him his picture of the livestock market; that their consistent pattern was to follow livestock prices very closely and to make commitments in conjunction with livestock prices; that if livestock prices rose, they took a position in accordance, if livestock prices declined they took a position accordingly; that they consistently adhered to a policy of making commitments in those commodities associated with the farm, livestock and farm products which generally went into feed, rather than metals and sugar, which they considered as having nothing to do with the taxpayer's livestock business. In his opinion, the losses suffered by the taxpayer in the commodity futures in 1947, 1948 and 1949 were solely and only the result of the protection and insurance against the hazards in his livestock business, like paying the premium on an insurance policy. He testified that the purpose of their advice and the procedure under it was to try to minimize the risks and hazards of taxpayer's livestock business, and in his opinion the commitments made in commodity futures were an integral part of the taxpayer's livestock business.

It is pointed out that the operation of the plan had the following practical result. In the early part of the year the taxpayer would sell short for delivery later in the year. If

the price of the futures went down, he made profits. If the price of the futures went up, he had losses. In the event of an economic decline the taxpayer would have losses in his accounts receivable, but would have offsetting profits in his commodity futures. If business improved instead of declining, the taxpayer would have a loss in his commodity future, but the marginal packers would be able to liquidate taxpayer's accounts receivable. Losses in the futures was the insurance premium for the protection of the accounts receivable.

I recognize that Mr. Weiss's testimony is not uncontradicted and may not be convincing to the Court. The majority opinion expresses such a view. It contains persuasive arguments in support of its holding that taxpayer's commitments in commodity futures were not an integral part of his livestock business. But it is not for the trial court or for this Court to decide whether under the conflicting testimony they did or did not constitute an integral part of his livestock business. It is well settled that "a verdict may not be directed for a defendant merely because the trial judge feels that, should the jury find in plaintiff's favor he would regard it as his duty in the exercise of a sound judicial discretion, to set the verdict aside." *O'Donnell* v. *Geneva Metal Wheel Co.*, 6 Cir., 183 F. 2d 733, 739, rehearing denied 190 F. 2d 59, cert. denied 341 U. S. 903, 71 S. Ct. 612, 95 L. Ed. 1342; *Heatherly v. Southern Ry. Co.*, 106 F. 2d 894, 895, C. A. 5th. This Court said many years ago, "The test is whether there is such an utter absence of substantial evidence as to make it his duty, as a matter of law, to set the verdict aside independently of the exercise of discretion, and without reference to how greatly the Court may think the conflict in testimony to preponderate in favor of defendant." *Begert* v. *Payne*, 6 Cir., 274 F. 784, 788 and restated in *Scott* v. *United States*, 6 Cir., 161 F. 2d 1009, 1012. I do not think that we are justified in completely discrediting and rejecting Mr. Weiss's testimony. That is the province of the jury. *Begert* v. *Payne*, supra, 6 Cir., 274 F. 784, 787. Unless the evidence is of such a character

that reasonable men in a fair and impartial exercise of their judgment would not reach different conclusions, the case should be submitted to the jury. *Bailey* v. *Central Vermont Ry.*, 319 U. S. 350, 353, 63 S. Ct. 1062, 87 L. Ed. 1444. Mr. Weiss's testimony was not so unreasonable or improbable as to cause it to be unanimously rejected by reasonable men. The jury obviously considered it reasonable and convincing. I think it was sufficient to take the case to the jury.

I would affirm the judgments.

2. *Judgment of the Court of Appeals*

(Caption omitted)

Filed January 27, 1961

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF KENTUCKY.

This cause came on to be heard on the transcript of the record from the United States District Court for the Eastern District of Kentucky, and was argued by counsel.

It is now here ordered and adjudged by this court that the judgments of the District Court in this cause be and the same are hereby reversed and the cases remanded to the District Court with instructions to dismiss the complaints.

APPENDIX B

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross Income" includes gains, profits, and income derived from salaries, wages, or compensation or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.***

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(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.,

In computing net income there shall be allowed as deductions:

• • • • •

(g) *Capital Losses.* –

(1) *Limitation.*,—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

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(26 U. S. C. 1952 ed., Sec. 23.)

INCOME: GROSS INCOME.

Gross Income Defined

SEC. 61. (a) *General Definition*

(a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;
(2) Gross income derived from business;
(3) Gains derived from dealings in property;
(4) Interest;
(5) Rents;
(6) Royalties;
(7) Dividends;
(8) Alimony and separate maintenance payments;
(9) Annuities;
(10) Income from life insurance and endowment contracts;
(11) Pensions;
(12) Income from discharge of indebtedness;
(13) Distributive share of partnership gross income;
(14) Income in respect of a decedent; and
(15) Income from an interest in an estate or trust.

(26 U. S. C. 1952 ed., Sec. 61).

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

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(26 U. S. C. 1952 ed., Sec. 117.)